

Policy Working Papers

July 1987

Number 8

FEDERAL BUDGET PROCESS REFORM: SURVEY AND ANALYSIS

by
William Orzechowski
Director of Federal Budget Policy

Control over the growth of public spending has to rank as one of modern civilization's most stubborn problems. Politicians continually pledge their allegiance to fiscal responsibility. Yet, fiscal responsibility has to be the world's most frequently broken promise.

The evidence is overwhelming. For example, in Europe total public spending averaged 30 percent of GNP in 1960. Today, in spite of many attempts to control spending, Europe is saddled with a public sector that takes up 50 percent of GNP. Although in the United States we have been more fortunate, the trend is in the same direction. Total public spending was approximately 29 percent in 1960. Today, it averages 38 percent. Even under Ronald Reagan, an avowed fiscal conservative, the federal share of GNP has risen from 22 percent in 1980 to 24 percent in 1986.

The relentless growth of public spending has caused many to search for solutions. In the United States many politicians have turned to budget process reforms. They have discerned that it is often difficult to obtain agreement among themselves to reduce spending on particular government programs. The pressure of special interest groups is often too great to withstand. As a consequence, they have turned to budget control devices that, in effect, force them to slow down spending growth. Without this "outside" restraint it is felt that Congress simply does not have the will to stay on the "diet."

The Experience With Budget Process Reform

The experience with budget process reform has not been impressive. Thirteen years ago, the entire budget process was overhauled with the passage of the Congressional Budget and Impoundment Control Act of 1974.

The purpose of this Act was to impart a sense of planning to the Congressional budget process. At that time, the thirteen appropriations committees were chiefly responsible for producing Congress' budget. A general criticism of this system was that it lacked coordination. The appropriations committees were accused of being too parochial in scope, making decisions that did not adequately reflect the national economic interest.

The new budget act was supposed to rectify these defects through the creation of budget committees in both houses of Congress and a Congressional budget resolution. The budget committees would develop a budget plan or budget resolution that would serve as a guide for the appropriations committees. The budget resolution would presumably promote the general view and curb the parochial interests of the appropriations committees.

In practice, it does not appear that the system has worked well. Since 1974, the first year of the current budget process, federal spending has more than tripled from \$267 billion to nearly one trillion in 1986. In the past seven years, Congress' spending has surpassed its own budget resolutions by an average of \$25 billion per year. Over the same time span Congress has missed its deficit goals, on average, by \$48 billion per year.

Gramm-Rudman-Hollings

Frustration with the current budget process led to the passage of the Balanced Budget and Emergency Deficit Control Act of 1985 or Gramm-Rudman-Hollings (G-R-H). G-R-H is a sweeping attempt at budget process reform, with the objective of forcing Congress and the President to reach a balanced budget by 1991.

The first part of G-R-H includes a schedule of deficit reduction targets. The targets are set each year to reach a balanced budget in 1991, beginning with a deficit target of \$144 billion in 1987. The second part of G-R-H is the automatic sequester.

The purpose of the sequester is to enable the President to make automatic across-the-board budget reductions if Congress cannot meet its deficit target. In this way it was hoped that the problems of the budget process could be skirted. In effect, if Congress failed to pass a fiscally responsible budget resolution or the resolution itself failed to control the appropriations committees, then the sequester would be activated by law.

Gramm-Rudman-Hollings received a serious setback in July 1986 when the Supreme Court declared that the automatic sequester was constitutionally invalid. This means that the sequester, if needed, must now be passed by joint resolution of both houses of Congress and the President. In 1986, our lawmakers were unable to ratify such a resolution.

So far the verdict is not completely in with regard to G-R-H. On the positive side, federal spending growth has been reduced significantly. Before G-R-H, federal spending grew at a 10.5 percent annual rate from 1980 to 1985. This growth rate has since been reduced to 4.5 percent in 1986 and is currently running at 3 percent. In addition, the deficit has now begun to fall from its \$220 billion level in 1986 and is expected to be about \$180 billion in 1987.

On the negative side, Congress and the President have not come close to meeting the G-R-H deficit targets, and the attainment of a balanced budget in 1991 is a remote possibility. For example, the projected 1987 deficit of \$180 billion is \$36 billion above the \$144 billion G-R-H deficit target for that

year. In 1988, the G-R-H deficit goal is \$108 billion, but our lawmakers are having great difficulty in developing a budget resolution that even meets a \$136 billion deficit goal. Indeed, the political momentum seems to be drifting toward a formal relaxation of the G-R-H targets.

Stumbling Blocks

In light of the setbacks with G-R-H and the current budget process, attention is focused once again on budget reform measures. However, the obstacles in the way of effective budget process reform are quite significant. In fact, many question if budget process reform can even make a difference.

One major problem is loopholes. The federal budget is comprised of thousands upon thousands of programs that are entwined in a maze of technicalities that permit special interests to maintain spending through one accounting procedure or another. This makes it difficult for Congress to police its own budget resolution.

There are many gimmicks or "procedures" that can be utilized to circumvent budget controls. These include shifting payments from the end of one year to the beginning of the next; underestimating program costs (when Medicare began in 1966 it was estimated to cost \$4 billion by 1980; it actually cost \$32 billion that year); bundling many appropriations bills in one large continuing resolution which makes it difficult for the President to veto a specific appropriations bill.

A second problem is accountability. If budget controls are violated, and it is easy to demonstrate that this occurs with alarming frequency, there are no significant penalties for violation.

Third, there is the genuine problem of a public that is ambiguous about its own fiscal preferences. The public may desire a balanced budget but it may not want to take the necessary steps to reduce particular spending programs.

In spite of these difficulties, some important budget reform opportunities are discussed in the sections that follow.

Recommendations for the Future

In order to tighten up the present budget process, a variety of reforms have been recommended. These reforms strive to eliminate loopholes in the present budget process. In some cases, they delegate stronger budgetary powers to the President. In other instances, they involve micro-specific procedural changes. Finally, some argue that meaningful reform implies an outright subordination of executive and congressional powers to constitutional limits.

- o **The Constitutional Balanced Budget Amendment**--By far, the most radical budget reform proposal is the balanced budget constitutional amendment. Many, including the recent Nobel

Laureate in economics, James Buchanan, see this as one of the few meaningful solutions available.

Advocates maintain that Congress and the Administration confront substantial barriers in limiting spending. In essence, the power of special interests is often too great to withstand. This is in spite of the many recent attempts to patch up the budget process. As a consequence, an outside "force", such as a constitutional balanced budget amendment, is needed to help Congress and the Administration. Our elected officials will find it easier to face the special interests by saying that the Constitution requires a balanced budget. They can say "your plan to increase spending must now compete with other plans for our limited resources, we can no longer pass the cost onto the taxpayer."

The operation of a balanced budget amendment is relatively straightforward. The federal government would be required by the Constitution to balance the budget on an annual basis. This requirement can be suspended in times of war and, in most versions, by a three-fifths majority in both houses of Congress. Some versions make it difficult to use tax increases in meeting the goal by imposing a constitutional tax limitation or requiring a super majority for tax increases. Many versions contain some provision for suspension if the economy is in a serious recession.

Currently, the most popular version in the House is an amendment, House Joint Resolution 321 (H.J. Res. 321), offered by Representatives Stenholm (D-TX), Craig (R-ID), B. Smith (R-OR) and Carper (D-DE). A similar version in the Senate, Senate Joint Resolution 161 (S.J. Res. 161), is being offered by Senators DeConcini (D-AZ) and Hatch (R-UT). The amendment requires an annually balanced budget unless waived by three-fifths majority. Tax increases require a majority of the whole number of both houses. Other provisions require the President to submit a balanced budget and require the President and Congress to submit a unified federal revenue estimate.

Making this provision the law of the land will be a difficult process. Any amendment to the Constitution requires a two-thirds majority in both houses of Congress and the approval of three-quarters of the states. In the House, H.J. Res. 321 already has 234 co-sponsors, putting it 57 votes short of the required two-thirds. In the House, the problem has been the Judiciary Committee which is reluctant to release such legislation to the floor. A discharge petition requiring 219 signatures is needed to get the bill on the House floor. One problem has been that some of the co-sponsors have failed to sign the discharge petition.

The Senate narrowly rejected a balanced budget amendment last year, and another attempt will likely be made this year. In 1983 the Senate passed a constitutional balanced budget amendment.

An alternative route is to bypass Congress and go right to the states. It takes two-thirds of all the states to pass the necessary legislation. So far, 32 of the 34 states required have made the call for a constitutional convention on the balanced budget. If one more state signs, this should provide sufficient pressure to get Congress to pass such an amendment. Future activity may occur in some states this year, especially Michigan, where the senate already approved a constitutional call.

One problem has been that in states such as Nevada, Texas, Florida, and Pennsylvania, efforts are underway to repeal the call for a constitutional convention. These rescissions have been turned back but future attempts remain a possibility. Opponents of a constitutional convention argue that the convention would not be limited to budget issues. Consequently, they fear that the Constitution could be laid open and modified in many other ways. But, the chances of this occurring are remote since Congress would more than likely enact its own version before the convention call, and also will review whatever the convention does. Moreover, it takes 38 states to pass a constitutional amendment, making it more difficult for extraneous amendments to pass.

- o **Line Item Veto**--From the time of George Washington to Richard Nixon, the president had the power to refuse to spend money for specific programs that Congress had appropriated. Congress had no formal procedure to overturn such action. However, the Budget and Impoundment Control Act of 1974 eliminated this presidential prerogative and replaced it with weaker substitutes. In order to give the President greater ability to reduce spending growth, a line item veto and enhanced rescission power have been recommended.

A line item veto would allow the president to veto specific portions of an appropriations bill. As of now the president can only veto an entire appropriations bill. The president is often reluctant to do this since such bills contain many items, some of which may be essential to his agenda. Moreover, Congress often bundles many appropriations bills in one large package called a continuing resolution. A veto of a continuing resolution can often lead to a government "shutdown" making it even more difficult to veto specific, inefficient projects.

A line item veto would rectify the inertia that now exists. The President could review programs on their own merits without being forced to "swallow" them as parts of a large package.

Congress, especially the appropriations committees, have been reluctant to grant the line item veto. They view the line item veto as a reduction in their discretionary powers. However, the line item veto merely restores the impoundment powers that were

eliminated with the 1974 budget act. Moreover, governors in 43 states possess such powers.

It is expected that line item veto legislation will be attached to debt ceiling legislation in mid-July. Senators Evans (R-WA) and Humphrey (R-NH) intend to offer such an amendment. As now proposed, their bill, S. 402., is actually a limited form of a line item veto that could be used only in conjunction with a continuing resolution, or when two or more appropriations bills are tied together.

- o **Enhanced Rescission Power**--Senator Quayle (R-IN) will offer his enhanced rescission bill, Senate Continuing Resolution 16 (S. Con. Res. 16), as an alternative to the line item veto. Under present rescission rules the President can propose to rescind funds for specific programs. However, in order for the rescission to take effect, both houses of Congress must ratify it. If Congress merely abstains, the rescission is voided and the spending continues. Less than one percent of all Presidential rescissions were acted upon by Congress during the last two years.

Enhanced rescission power would "turn the tables" by requiring Congress to vote against the rescission if they want to retain the spending program. As a consequence, Congress would have to go on record as favoring more spending than the President.

- o **The Automatic Sequester**--The automatic sequester was intended to be the "backbone" of the historic Gramm-Rudman-Hollings (G-R-H) legislation. According to G-R-H, Congress and the Administration are responsible for setting a yearly budget that would reduce the deficit in a series of incrementally lower deficit targets until budgetary balance is restored in 1991. Consequently, in each year our lawmakers must reach a specified deficit target. If Congress failed to meet these targets in any year, the automatic sequester would be triggered and spending would be cut on an across-the-board basis until the target is reached.

Unfortunately, the automatic sequester was declared unconstitutional by the Supreme Court. In its place is a joint resolution of Congress and the President. It is no longer "automatic" because if either house of Congress or the President dissents, the sequester fails. Last year, the sequester was rejected by joint resolution.

In order to restore the automatic sequester, legislation has been prepared to make the Office of Management and Budget (OMB) the executor of the sequester. This would rectify the constitutional defect of the earlier version. Senator Gramm (R-TX) has introduced legislation along these lines (S. 75), and it is expected that the bill will also be attached to debt ceiling legislation.

S. 75 contains other amendments aimed at strengthening the G-R-H process. One problem with G-R-H is that many programs are exempt from the sequester. An important reform is widening the spending program base for a potential sequester. This would spread the sequester over more programs, thereby reducing the amount any single program must absorb.

S. 75 has substantial support in the Senate where a similar version was passed last year by an overwhelming majority. The problem has been in the House where there is mounting support for an alternative sequester that has to be triggered by the President. This would make the President take the "heat" for spending cuts and absolve Congress. There is also the possibility that some members of Congress will want to weaken or stretch out the G-R-H deficit targets as part of new sequester legislation.

- o **Biennial Budget**--There is considerable interest in a biennial or a two-year budget. Many lawmakers are convinced that a biennial budget can whittle down many of the procedural problems associated with the current budget process.

With current procedures a great deal of Congress' time is spent on a one-year budget resolution. Deadlines are often missed and decisions are postponed to the end of the fiscal year resulting in a large continuing resolution. This has created a variety of problems. First, too much time is wasted on budgetary issues. Second, the confusion and complexity that occur at the end of the fiscal year make it easier to push through inefficient programs. Third, the power of the authorization committees becomes diluted because there is little time to consider the thousands of programs the government operates.

With a biennial budget, the first year would be spent putting together a two-year budget and appropriations bills. The other year would be spent on multi-year authorizations. One prime advantage is that less time would be allocated to budgetary issues since budget plans would extend for two years. With two years to plan a budget, authorizations (the law that enables spending) would rationally precede and guide the development of appropriations bills. As a consequence, a biennial budget would help avoid the year end budget "crunch" associated with current practice.

A biennial budget is hypothesized to lead to greater fiscal responsibility. One argument is that with a two-year cycle, there is less chance for special interests to push their case for more spending. Congress would only have to deal with this pressure every other year. A two-year budget also has the virtue of making out- or second-year budget reductions stick. As a consequence, Congress can deflect special interest pressure by deferring

spending reduction plans in the second year. With a biennial budget these out-year spending reduction plans will have the force of law.

Opponents argue that it is difficult to develop a two-year budget in light of economic uncertainties. As a consequence, there will be greater need for supplemental appropriations. Others argue that if the biennial budget gives Congress more time, then it might be used to support more not less spending programs.

The biennial budget has considerable bipartisan support. In the House, Representatives Panetta (D-CA) and Regula (R-OH) have developed such a proposal. In the Senate, Senators Domenici (R-NM) and Roth (R-DE) are expected to introduce similar legislation which will be attached to the debt ceiling bill in mid-July.

- o **Capital Budget--**Adoption of capital budgeting would bring federal practice in line with standard business accounting principles. Proponents argue that it makes no sense to treat all federal investment outlays as ordinary expenses. Just as capital outlays of business firms are not wholly charged against current revenues to determine a firm's profit or loss, federal investment spending would no longer have to be counted as adding to the federal deficit in the year when such spending actually occurs. Instead, the budgetary cost would be allocated over a period of years approximating the life of the investment.

Critics suggest that a capital budget would arbitrarily lower the computed deficit which would mean less pressure for budget control. A capital budget would also make it easier to push through spending projects since the capital costs would be amortized. In the private sector, there is little room for abuse with this practice since the firm is personally liable for the cost of capital purchased. In the public sector, there is the real danger that the amortization concept will be seriously abused. This is because politicians are not personally liable for capital costs, and there is a genuine threat that they would attempt to pass the costs of poor investments onto the taxpayer. In this sense full cost accounting can be viewed as a barrier against such abuse.

A complete capital budget implies an estimation of the future liabilities of entitlement programs. Serious problems exist with estimating these liabilities. A slight change in economic and demographic assumptions mean a greater change in the imputed entitlements deficit.

- o **Budget Resolution by Joint Resolution--**The Reagan Administration has many times recommended that the President should be a co-signer of the budget resolution. Their argument is that the executive branch of government should have a more direct impact

over the federal budget. They feel that the President is less susceptible to special interests since the President is elected by the entire population. By contrast, Congress is more likely to be affected by local and more narrowly focused constituencies.

Budget "Stingers"

There are a number of micro-specific budget reform changes that can have at least a modest effect in reducing the growth of federal spending. Most of these proposals attempt to patch up some of the more glaring loopholes in the present budget process.

- o **Stronger Reconciliation**--A reconciliation bill contains specific instructions that determine how spending reductions mandated by the budget committees are to be carried out. However, extraneous legislation that may increase spending is often attached to a reconciliation bill. A prohibition of extraneous legislation has been recommended to deal with this problem.
- o **Spending Caps and Ceilings**--The appropriations committees, especially in the House, can often maneuver around some of the spending limits set by the budget committees. In order to curtail such behavior, firmer limits or ceilings on appropriations bills have been recommended.
- o **Defense-Nondefense Allocations**--A common practice by the appropriations committees has been to reduce allocations set by the budget committees for defense spending for the purpose of increasing nondefense spending. Proposals have been put forward to end this practice by setting enforceable caps for defense and nondefense spending.
- o **Control of Continuing Resolutions**--The budget year often ends with a large continuing resolution that bundles many appropriations bills into one large package. This makes it difficult to weed out inefficient programs. In order to comb through a continuing resolution for inefficient spending, line item veto or enhanced rescission power could be granted to the President. Such powers would be limited to the continuing resolution. Other recommendations would make it difficult to add spending bills to the continuing resolution.
- o **Credit Reform**--In order to control the growth of federal loans and loan guarantees, sweeping reform has been proposed. New loans would be estimated for their subsidy content, and the agency responsible would have to obtain appropriations equal to the subsidy. Old loans would be sold to the private sector at a discount that reflects the rate of subsidization. In this way the massive subsidies imbedded in such programs would come to light and program abuse would be discouraged.

Conclusion

It is no secret that the current budget process contains many defects. Deficit targets have been routinely missed. There seem to be a million and one ways to avoid budget controls. As a consequence, budget process reform has become an important legislative issue, once again.

Unfortunately, the problem runs deep and may require significant institutional change such as a constitutional balanced budget amendment. In the short run, however, there exist a number of promising budget process reforms. These include the automatic sequester, line item veto, biennial budget and a host of procedural recommendations. Most of these proposals are expected to receive national attention in conjunction with this year's debt ceiling bill.